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In the Supreme Court of the United States

OCTOBER TERM, 1988

CBC, INC., PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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Petitioner challenges a determination by respondent Board of Governors of the Federal Reserve System that the Board has authority under the Bank Holding Company Act (BHCA or Act), 12 U.S.C. 1841-1848, to require bank holding companies having more than $150 million in consolidated assets to submit financial statements that are certified by an independent public accountant as a part of the companies' annual report to the Board.

1. The BHCA comprehensively regulates bank holding companies. Section 5(c) of the Act, 12 U.S.C. 1844(c), provides that the Board "may require reports under oath to keep it informed as to whether the provisions of [the Act] and such regulations and orders issued thereunder have been complied with." Pursuant to that provision, the Board has long required bank holding companies to sub-

mit annual reports of operations in a prescribed form (Form FR Y-6). 12 C.F.R. 225.5(b).

On July 9, 1985, the Board issued a proposed regulation revising the reporting requirements for Form FR Y-6 and other forms. 50 Fed. Reg. 28,026. The Board proposed to modify the existing requirement that bank holding companies having at least $100 million in consolidated banking assets must submit financial statements certified by an independent public accountant. Under the proposed revision, bank holding companies with total consolidated assets (nonbanking as well as banking) exceeding $150 million were to be required to submit certified financial statements. *Id.* at 28,030. The Board stated that the proposed change would reduce the reporting burden for some bank holding companies. *Ibid.*

2. Petitioner, a bank holding company with total consolidated assets in excess of $150 million, submitted a comment on the proposal objecting to the certified financial statement requirement. R. 29-245. Petitioner argued that the Board lacks statutory authority to require certified financial statements. Petitioner suggested that the Board is required instead to rely on reports of examinations of subsidiary banks made by other federal and state bank regulators. R. 30-48.

On December 13, 1985, the Board adopted the proposed revision to Form FR Y-6 requiring bank holding companies with total consolidated assets in excess of $150 million to submit auditor-certified financial statements. 50 Fed. Reg. 50,950, 50,951. As statutory authority, the Board relied on Section 5(c) of the BHCA. *Id.* at 50,956. The Board explained that the certification requirement promotes safe and sound operations. *Ibid.*

3. On a petition for review filed by petitioner under 12 U.S.C. 1848, the court of appeals upheld the Board's modified regulation. Pet. App. A1-A19. The court con-

cluded that the Board's requirement of certification by an independent accountant is based on a reasonable construction of BHCA Section 5(c), which authorizes the Board to require reports from bank holding companies. Pet. App. A6-A17. The court found that financial statements certified by an independent accountant fall within the ordinary meaning of the statutory term "reports" (*id.* at A6-A9) and that the auditor-certification requirement is consistent with the purposes of the Act because it enables the Board to meet its statutory responsibility to obtain reliable evidence of the commercial credit practices and financial positions of bank holding companies and their subsidiaries (*id.* at A9-A12).

The court of appeals also concluded that the Board must be permitted to require reports of a bank holding company's subsidiary banks, as well as of the holding company itself, in order to give effect to the purposes of the Act. Pet. App. A12-A13. Further, the court found that the Board was not required to use examination reports prepared by other bank supervisory authorities in lieu of certified financial statements, explaining that the Board is required to use such examination reports only "as far as possible" (12 U.S.C. 1844(c)) and that petitioner had failed to show that such reports produce the same reliable, complete, timely information as the more frequent reports required by the Board. Pet. App. A13-A17. Finally, the court concluded that the Board's selection of $150 million in consolidated assets as the minimum threshold for the certified financial statement requirement is within the Board's discretion under the statute and is arbitrary and capricious. *Id.* at A17-A19.

4. The Board's determination that BHCA Section 5(c) authorizes it to require financial statements in annual reports certified by independent public accountants was correctly upheld as a permissible construction of the statute by the agency charged with administering it. See

Chevron U.S.A. Inc. v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984); see also *Northeast Bancorp, Inc.* v. *Board of Governors*, 472 U.S. 159, 168 (1985) (Board is "an authoritative voice on the meaning of a federal banking statute"); *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 251 (1978).[1] Section 5(c), 12 U.S.C. 1844(c), provides that "[t]he Board from time to time may require reports under oath to keep it informed as to whether the provisions of [the Act] and such regulations and orders issued thereunder have been complied with." The provision gives the Board substantial discretion to determine the form and content of required reports, and the language is plainly broad enough to encompass a requirement of certified financial statements—like those in an "auditor's report"—as long as the requirement reasonably advances the Board's ability to carry out its responsibilities under the BHCA.

The requirement of auditor-certified financial statements at issue in this case advances the Board's ability to carry out its statutory duties to monitor the financial condition of bank holding companies to ensure their safe and sound operation. For example, the Board must consider

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[1] In 1957, the year after enactment of the BHCA, the Board began requiring relatively large bank holding companies to submit annual reports with financial statements certified by independent accountants. 22 Fed. Reg. 2341 (1957). Since then, although specific reporting requirements for the annual report have been modified from time to time, the direction that financial statements submitted with annual reports be certified by independent accountants has, with one brief exception, been continuously retained for covered bank holding companies. *E.g.*, 31 Fed. Reg. 14,800 (1966); 32 Fed. Reg. 3813 (1967). In 1975, the Board allowed all bank holding companies to submit annual reports with unaudited financial statements, but the following year the Board reinstated the requirement of certified statements for bank holding companies with consolidated banking assets of more than $100 million. R. 89-90.

the financial condition of a bank holding company when the company acquires a bank or nonbank company. 12 U.S.C. 1842(c), 1843(c)(8); *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. at 243, 249-251; 12 C.F.R. 225.24. In addition, the Board may terminate any direct or indirect nonbanking activity of a holding company if, among other things, the activity poses "a serious risk to the financial safety, soundness, or stability of a bank holding company subsidiary bank." 12 U.S.C. 1844(e). Also, Section 5(c) specifically authorizes the Board to "make examinations of each bank holding company *and each subsidiary thereof.*" 12 U.S.C. 1844(c) (emphasis added). See also S. Rep. No. 1084, 91st Cong., 2d Sess. 24 (1970) (BHCA purpose "to prevent possible abuses related to the control of commercial credit"); Pet. App. A10-A11. In short, the particular reporting requirement at issue here is reasonably related to the Act's purposes and the Board's functions under the Act.[2]

The requirement of financial statements certified by independent accountants is entirely consistent with Section 5(c)'s direction that the Board "shall, as far as possible, use the reports of examinations made by the Comptroller of the Currency [the primary supervisor of national banks],

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[2] Contrary to petitioner's assertion (Pet. 12-20), the decision of the court of appeals upholding the Board's regulation does not conflict with this Court's holding or reasoning in *Board of Governors* v. *Dimension Financial Corp.*, 474 U.S. 361 (1986). *Dimension* involved administrative interpretations of the terms "demand deposit" and "commercial loans" in the BHCA's definition of "bank." 474 U.S. at 364-365. In contrast to the Board's construction of the authority to require "reports" in Section 5(c) of the Act, this Court found in *Dimension* that the Board's interpretation of the "bank" definition was inconsistent with the unambiguous meaning of the statutory language. 474 U.S. at 373-374. Here, the construction adopted by the Board is fully consistent with the common understanding of the "plain language" of Section 5(c) of the BHCA.

the Federal Deposit Insurance Corporation, and the appropriate State bank supervisory authority." 12 U.S.C. 1844(c). That direction by its terms provides only that examination reports of bank supervisors shall be used "as far as possible." Moreover, Section 5(c) expressly contemplates that the Board itself "may make examinations of each bank holding company and each subsidiary thereof." Here, as the court of appeals concluded (Pet. App. A14-A17), there is a reasonable basis for the Board to conclude that the supervisory agencies' examination reports relating to subsidiary banks of holding companies do not fully substitute for a certification by an outside auditor of financial statements contained in the holding companies' annual reports. Even aside from the fact that bank examinations may not as heavily focus on the propriety of the company's accounting methods and the adequacy of the company's mechanisms to detect and deter fraud, complete bank examinations in many cases are performed only at irregular intervals of up to three years. *Id.* at A15. And updates of such examinations may provide less complete information than can the annual audits required by the Board. *Id.* at A15-A16.

Finally, the Board acted reasonably in applying the requirement of a certified financial statement to all bank holding companies with more than $150 million in consolidated assets. Selection of such a threshold involves weighing the costs of compliance for smaller institutions against the supervisory benefits to be achieved by the certification requirement; and any particular threshold dollar figure is necessarily arbitrary in the sense that a slightly higher or lower figure is not materially distinguishable. An agency must have wide discretion in selecting such a threshold. Here, the Board's selection of $150 million in total assets as a threshold was reasonable, as the same threshold has

been used to identify smaller bank holding companies for various other regulatory purposes.[3]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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[3] For example, under the Board's guidelines for determining the capital adequacy of banking institutions, bank holding companies with less than $150 million in consolidated assets are generally allowed to determine compliance based on the capital of the subsidiary bank alone. *E.g.*, 71 Fed. Res. Bull. 445, 446 n.1 (1985); 54 Fed. Reg. 4186, 4209 (Jan. 27, 1989). The Board has also used a benchmark of $150 million in consolidated assets to identify certain types of shell bank holding companies that are small enough that supervisory examinations may be performed less frequently than for larger companies. Fed. Res. Regulatory Serv. para. 3-1531 (1985).

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